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Summary of corporate insolvency regimes and the new "business debt hibernation" regime

Given the challenging business conditions as a result of the Covid-19 pandemic, an unfortunate consequence may be that we see a number of businesses fail.

In light of this we set out below an overview of the various corporate insolvency regimes. In addition, we also discuss a new creditor compromise arrangement called Business Debt Hibernation that the Government has announced to assist companies through these challenging times, in the hope that insolvency can be avoided.

Liquidations

The most common form of insolvency is liquidation where a liquidator is appointed. This may be by the application of a creditor to the court or by shareholders resolving by special resolution. The relevant provisions dealing with a liquidation are contained in the Companies Act 1993 (**Act**). On appointment of a liquidator the directors' powers are suspended and the liquidator has custody and control of the company's assets. The company ceases trading and the principal duty of the liquidator is to take possession and realise the company's assets for the benefit of the creditors. Unsecured and preferential creditors (such as the IRD and employees) will be paid a pro rata share of the liquidation funds in order of priority as set out in Schedule 7 of the Act. This order, in broad terms, is the payment of the liquidators' fees, secured creditors (such as the bank), preferential creditors, unsecured creditors and lastly shareholder capital. All unsecured creditors must be treated equally and if a creditor has been paid ahead of another creditor in the period leading up to the company's liquidation when the company was insolvent, the liquidator can seek to overturn and recover the payment as a "voidable preference".

Receiverships

A receiver is appointed by a secured creditor, such as the bank, through powers contained in its security over the company's assets and the Receivership Act 1993. The most common form of charge used to appoint a receiver is a General Security Agreement (**GSA**). The receiver's primary duty, once appointed, is to the secured creditor that has appointed the receiver. However a receiver has secondary duties to unsecured creditors, guarantors and shareholders to take reasonable care with the assets of the receivership, particularly on realisation of those assets. The receiver owes a specific duty when selling the company's property to *"obtain the best price reasonably obtainable at the time of sale*".

The receiver's powers only extend to the assets that are the subject of the secured creditor's security. In most cases where this is a GSA the charge will be over all the assets of the company giving the receiver full control. The receiver, once appointed, may elect to trade in receivership or shut the business down depending on the state of the business and what is in the best interest of the creditors. In many cases, the receiver will trade the business pending its sale as a going concern or on rare occasions even seek to trade it out of receivership.

A receiver must resign once the appointing secured creditor has been repaid. On completion of the receivership, a liquidator may be appointed to take over the affairs of the company to deal with any outstanding matters including claims against directors and dealing with voidable transactions to enable recovery for other creditors.

Voluntary administration

The voluntary administration (**VA**) procedure was introduced in 2016. The purpose of the procedure is for an insolvent company to be administered in a way that maximises the chances of the company surviving or if it is not possible for the company to survive then to

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administrate the company in a way that improves the return to available to creditors if it went into liquidation. The administration process begins with the appointment by an administrator. The administrator can be appointed by the directors of the company, a liquidator, a secured creditor or the court.

The administrator has 8 working days to call the first creditors' meeting for the directors to table an initial statement concerning the affairs of the company and financial position. A second meeting then must be called within 20 days of the appointment of the administrator. At this meeting the administrator may put forward a "deed of company arrangement", known as a "DOCA", or recommend that the company go into liquidation. The DOCA may be for the orderly sale of the business' assets or a compromise of creditors leading to the company's recovery. The DOCA must be approved by 50% in number and 75% in value of creditors at the second meeting (known as a Watershed Meeting).One of the main drivers for a VA is the statutory moratorium on creditor action once the administrator is appointed. The court has described it as *"providing a breathing space free from creditor enforcements, steps and proceedings during which the administrator can assess the company situation*."

The moratorium extends to guarantee proceedings against directors. The VA regime has not had large uptake in New Zealand as it has been seen as cumbersome and expensive to manage with the inevitable need for applications to the court for timeframe extensions and applications by secured creditors to preserve their rights.

Creditors' Compromises

The provisions dealing with creditors' compromises are contained within Part XIV of Act. A compromise is an agreement between the company and its creditors to pay all or part of the debts over the term of the compromise. In addition, during that time there is a moratorium on any creditors bound by the compromise taking any action against the company for debts existing at the time the compromise is agreed.

The moratorium, unlike voluntary administrations and business debt hibernations, is not immediate and does not commence until the compromise has been approved at a creditors' meeting. The compromise must be approved by 50% in number and 75% in value for it to be binding. It must be approved by each class of creditors including unsecured, preferential and secured creditors. Typically, only unsecured and trade creditors support the compromise with separate arrangements having to be made with preferential creditors such as the IRD and secured creditors such as the bank.

Given the moratorium is not immediate, compromises are often a race against time to get the compromise passed prior to a creditor putting the company into liquidation.

Usually, the compromise will appoint an independent manager to manage receipts and payments under the compromise.

Business Debt Hibernations

The Business Debt Hibernation regime is a new temporary measure being brought in to assist companies who have difficulties paying their creditors as a as a result of the crisis. It is initiated by the debtor, similar to an administration or creditors' compromise, but it leaves the directors in control of the company. The level of creditor approval is less, being 50% in number and value (as opposed to 50% in number and 75% in value for an administration or compromise). Unlike a compromise, the moratorium is immediate on the notice being given by the debtor. The process is designed to be quick and flexible so that directors can commence the process themselves. It is expected that the Companies Office will provide a form for completion by a debtor. Creditors who continue to trade with the company will be protected from voidable preference claims during the moratorium if the company subsequently goes into liquidation (so long as they are

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not a related party, have acted in good faith and without intent to deprive other creditors of the company). The details of the legislation is not yet known, but once passed it will be backdated to the start of the lockdown period at level 4.

Want to know more?

If you have any questions about insolvency related matters, please contact our specialist insolvency and restructuring team.